From the Desk of Robert Vanderhooft

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Robert is also **Chair** of the **TD Wealth Asset Allocation Committee (WAAC)**, which provides broad asset allocation guidance to all of TD Wealth.

In his note below, Robert provides his latest insights on recent events affecting the markets and his strategy outlook.

TDAM View: Market Update

Coronavirus (COVID-19) continues to rattle global financial markets, leaving investors and policy makers to operate in an environment of great uncertainty. First and foremost, we recognize the impact COVID-19 is having on families and communities around the world, and hope containment measures are successful at quickly controlling and eradicating this virus.

While equity losses so far do not compare to the crash experienced during the Great Financial Crisis (2007-08), the magnitude and speed of the current drawdown has been one of the most significant in the history of public markets. Slowdown related declines in oil demand combined with Saudi Arabia increasing production, have not helped the situation, as oil prices have spiraled below $30 a barrel on West Texas Intermediate, but even more impactful for Canada has been the drop in Western Canada Select to below $20 a barrel. Meanwhile, as investors rushed to safer assets, credit spreads in corporates and high yield responded by widening significantly with bonds also experiencing declining liquidity.

Central bank and government actions in response to this global crisis already make for a long list that is getting longer as nations continue to step in to lower rates, provide fiscal stimulus and bolster liquidity in markets. As we saw with the U.S. over the weekend governments are looking to take significant action to limit and flatten the curve of virus transmission but also to support rapidly slowing economies and industries. In a dramatic move, the U.S. Federal Reserve announced it would drop interest rates to almost zero and buy at least $700 billion in government and mortgage-related debt as part of wide-ranging emergency action to protect the economy from the deteriorating conditions. The moves are aimed at keeping financial markets stable and making borrowing costs as low as possible for businesses and consumers.

There remain many unknowns surrounding the severity and longevity of the outbreak but most economic projections, with which we would concur, indicate a global slowdown in economic growth to near 2% which is widely considered recessionary levels. The U.S. and Canada are very likely to see two or more

quarters of no growth or some contraction over the first half of 2020. Our long run expectation is for a relatively rapid recovery when the pandemic is ultimately contained, and we can point to some good news on that front that has come out of China. China with almost no new cases has begun to see rebounds in both economic activity and in the financial markets.

While volatility is likely to persist, our expectation is that looking 18 to 24 months out we will have seen positive equity returns from these levels. As markets recover we would also expect bond yields to move closer to pre-crisis levels. We are not expecting a meaningful increase in credit defaults in the Canadian investment grade space which should also help corporate spreads to recover. That said, we are on guard for sources of potential downgrade risk and are closely monitoring liquidity conditions across asset classes. We remain cautious but in balanced portfolios where we have seen equity weightings drop well below long term targeted weightings we are beginning to add back to those equity weightings. Below is a summary of our views and outlook for major asset classes.

Asset Class Overview

Equities

As outlined earlier the situation is fluid as health authorities and policy makers around the world are taking measures to help curb the spread of the virus. Companies will be affected by the reality of a locked-down world of restricted travel, closed schools, cancelled conventions and suspended sports leagues.

Remaining calm in periods of financial market uncertainty is often challenging for investors. At TDAM we continue to actively review the risks in every holding in the fundamental public equity portfolios, given the current market dislocation, looking not only at what the risks are, but to the degree the market has sold off and where the opportunities may be. Ultimately what matters for the economies is the path of the virus and the measures which national authorities will take to contain it, which will have varied implications for the sustainability and outlook of companies and industries. Though we cannot predict the exact timing of the economic recovery, we seek to ensure that the fundamental equity portfolios are weighted to industries and companies that will participate in the recovery. One of the core themes of our investment process is balance sheet strength. In a challenging environment, our equity holdings with solid balance sheets and strong cash flows should be more resilient. Our global team of industry analysts understand that the COVID-19 impact on industries and companies are very different. With the recent broad pullback in equity prices, we are looking at not only what the evolving risk circumstances are but also seeking to find attractive opportunities to add high quality companies with good management teams that meet our disciplined investment criteria at lower prices.

Alternative Assets

By nature, private markets are more immune to market volatility spurred by unforeseen crisis. Whether it is direct real estate, infrastructure assets or private debt, these holdings are typically secured by long term contracts and owned by institutional investors with long term time horizons and strong balance sheets that are better able to weather short-to-medium term softening economic conditions. Performance observations of real assets through the SARS epidemic and the H1N1 pandemic reveals generally positive performance driven by stable income characteristics. While it is certainly too early to estimate the magnitude or duration of the current COVID-19 pandemic, we believe the primary role of private alternative asset classes is to deliver capital preservation, stable income and low correlation to other asset classes.

Real Estate

Demand for direct real estate remains high with investors searching for yield in today's even lower interest rate environment. Investors are currently looking to take advantage of lower re-financing costs as credit availability may become scarcer if market uncertainty persists for an extended period. Should the pandemic endure, which is not our base case, this may lead to a slowdown in transaction activity as investors pause to evaluate the effects. Leasing activity within the office space is already starting to become protracted, as companies look to delay capacity-driven decisions, and home-working increases. Depending on the location, hospitality and retail assets will temporarily experience a decline in foot traffic. Hotels in particular will have occupancy and room rate impacts, while certain retail centres will see a reduction in mall productivity. On the positive side demand for distribution and warehousing space may remain resilient as supply chains shift to local regions. Finally, multi-family assets should provide continued capital preservation and income predictability, given their countercyclical characteristics and strong fundamentals. Real estate portfolios well diversified across different property types and locations are better positioned to manage investment risks associated with the current pandemic.

Infrastructure

Within infrastructure, the certainty of cash flows are driven by the contract or revenue earned, generally falling into three categories: 1) Regulated; 2) Contracted; and GDP-linked. Regulated and contracted assets such as utilities, renewable energy and power provide greater certainty and income is less impacted by the economic cycle. Gross Domestic Product (GDP)-linked infrastructure assets such as transportation assets are likely to see the greatest impact to valuations in the event of a prolonged downturn. Moreover, a prolonged slowdown in GDP would have an impact on value-add and greenfield infrastructure assets. Ultimately, as infrastructure represents critical services to an economy, and significant up-front capital expenditures, long-term returns are less sensitive to shorter term shocks in demand.

Private Debt

The strong demand for real assets, stimulated by low interest rates, is driving significant private lending in the market. In the mortgage area recent interest rate volatility is leading lenders to focus on negotiating interest rate floors within their loans. As market uncertainty persists, lenders are expected to gravitate even more to high quality assets that generate stable, predictable income streams and enhanced capital preservation. Underwriters have also begun tightening loan fundamentals (e.g. lower loan-to-value, higher debt service coverage ratio) and requiring improved covenants and/or recourse. Lenders who are able to lend across multiple sectors, locations and loan types should be able to achieve higher yield premiums.

Overall, we believe that investors can take comfort in the long-term contractual cash flows that alternative asset classes offer. Within the different alternative asset classes, broad portfolio diversification and active management protect client capital from shocks and prolonged distress in the markets.

Fixed income

While North American central banks are appropriately taking action in response to the heightened potential for economic and liquidity contraction we are continuing to see enormous volatility in the bond markets. Following the Bank of Canada's (BoC) decision to lower overnight rates by 50 basis points (bps) March 4, on March 12 the BoC shifted their focus to bolstering liquidity within the financial system before March 13 in a surprise move cutting a further 50 basis points to 0.75 percent on their policy rate.

There is no question the BoC is acting proactively in an effort to counteract short-term funding stresses in the market by increasing the frequency of their repurchase operations to weekly from every two weeks,

and widening the terms to include 6 month and 12 month operations. In addition, the BoC is increasing the scope of their bond buyback program by allowing primary dealers to swap off-the-run Government of Canada bonds with newer, more liquid issues. These moves by the BoC came just shortly after the Federal Reserve (Fed) took aggressive steps to ease what they called "temporary disruptions" in Treasuries, communicating to the markets a promise to provide $5 trillion in liquidity while also widening their purchase program for U.S. government bonds.

The COVID-19 outbreak has been an unforeseen driver of economic uncertainty. As a result of that uncertainty, demand for safe assets pushed government yields to historical lows with rates below 1% across the maturity spectrum. Taking the 10-year government of Canada bonds as a barometer for fixed income markets, yields fell from 1.10% at the beginning of March to 0.68%. In recent days we have observed a steepening of the Canadian yield curve as central banks cut rates and longer-term yields began looking through to the long-term effects of stimulus.

The credit markets were not immune to repricing of risk with corporate credit spreads widening rapidly reflecting this increased risk to the global economy. In this environment the TDAM research team is applying rigorous stress tests to approved credits, looking to identify corporate issuers that may warrant increased caution should they have insufficient liquidity to weather an economic contraction. In addition, recent corporate actions imply that corporations are looking to shore up capital by drawing down on their committed revolving credit facilities. While we do not expect a material increase in investment grade defaults, our credit research team is working diligently to identify credits where the risk of downgrade has increased.

For now, given the lack of visibility in regard to the COVID-19 outbreak, we remain committed to finding dislocations in the market, and are cautiously deploying capital to help take advantage of these opportunities. We believe that financial conditions will remain supportive as central banks have communicated their clear commitment to taking a "whatever it takes" approach to help ensure the stability of the global financial system.

In TD Greystone fixed income mandates where we are focused on duration management, we have maintained a modest below-benchmark duration. We are looking for signs that headline risk from the virus has played through markets and will look to reduce duration further as markets stabilize and we return to higher rates

All of our investment strategies and portfolios are designed to effectively manage market risk, particularly during periods of elevated market volatility, by investing in what we believe are high-quality securities and assets that are best positioned to deliver quality long-term outcomes.

While recent market activity has created significant investor caution, TDAM's investment professionals are continually evaluating and re-evaluating the investment environment for both risks and opportunities to best position portfolios in a rapidly changing crisis. Should you have any questions related to your portfolio, please reach out to your Relationship Manager.

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